

# California Fair Political Practices Commission

## MEMORANDUM

**To:** Chairman Getman and Commissioners Downey, Knox, and Swanson

**From:** Holly B. Armstrong, Commission Staff Counsel  
John W. Wallace, Assistant General Counsel  
Luisa Menchaca, General Counsel

**Re:** *In re Hanco* (O-02-088), Treatment of Bonus Payments under Section 87103(c)

**Date:** May 24, 2002

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### I. Introduction

Roger A. Brown, counsel for the Peninsula Health Care District, ("District") is requesting an opinion on behalf of one of the members of the District's board of directors, Terilyn Hanco. The Executive Director granted the request on April 16, 2002. (Regulation 18320(e).) Mr. Brown agreed to defer Director Hanco's request for a formal opinion from the May Commission meeting to the June meeting. Therefore, the request is set for its first hearing on June 7, 2002. This memorandum discusses the issues raised by this request. The issues are framed in a manner to respond to Director Hanco's question if the Commission chooses to issue an opinion regarding this matter.<sup>1</sup>

### II. Question Presented

Should bonus payments made by a private employer to a public official, which are triggered by purchases made by a customer of the employer, be attributed to the customer, making both the customer and the employer sources of income?

### III. Commission Options

The following options are presented to the Commission:

1. The Commission may decide to render an opinion that concludes that where purchases of a business from an official's employer trigger the payment of a bonus to the official from the employer, that business is not considered a source of income to the official. This would result in superseding prior Commission staff advice.

2. The Commission can issue an opinion modifying the advice. While staff does not agree that all of the factors proffered by the requestor are relevant, it is an option for this

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<sup>1</sup> The adoption of the opinion would be set for July 2002.

Commission to place limiting factors on this rule, without abandoning the rule entirely. This would mean that, depending on the existence of the factors the Commission selects, Director Hanko may or may not participate in decisions directly affecting the client. If the Commission selects this option, staff would suggest that a regulation project be set for next year defining when bonus payments may be imputed to a client of the official's employer.

3. The final option would be for the Commission to ratify the advice in the staff letter declining reconsideration of this issue (*Brown* Advice Letter, No. A-01-286). Under this last circumstance, a regulation may still be desirable in the future. However, the Commission would not need to move forward on this opinion.

#### **IV. Facts**

##### **The District:**

The Peninsula Health Care District ("District") is a local health care district organized under the provisions of the California Health and Safety Code §§ 32000 et seq. For more than a year, the District has been negotiating a contractual "restructured relationship" with Mills Peninsula Health System ("MPHS"), a wholly owned subsidiary (as that term might apply in the non-profit sector) of Sutter Health ("Sutter"). Both MPHS and Sutter are California non-profit public benefit corporations. MPHS is a local entity operating the San Mateo health system, which consists of the merged operations of Peninsula Hospital and Mills Hospital. Sutter is a large multi-hospital system. MPHS affiliated with Sutter in January 1996.

In 1985, the District entered into a 30-year lease of its hospital, Peninsula Hospital in Burlingame (the "Hospital"), with MPHS, pursuant to which MPHS operated the Hospital and the District became the landlord. In 1997, the District commenced litigation against MPHS, seeking to invalidate the lease based on circumstances underlying the negotiation and execution of the lease. In 1998, while the litigation was pending, seismic safety regulations were issued by the state implementing SB 1953, legislation enacted in 1995, mandating earthquake structural integrity standards for California hospitals. After each conducted independent engineering studies, both the District and MPHS concluded that the Hospital would need to be replaced with a newly-constructed facility. Recent amendments to the original legislation mandate replacement of the facility by the year 2013. The District and MPHS then began to negotiate a resolution of the issues created by SB 1953 and the lawsuit.

The negotiations between the District and MPHS were aimed toward a global settlement of the litigation by which MPHS (assisted with financing from Sutter) would construct and operate a new hospital on land leased from the District, subject to terms guaranteeing specified community benefits and granting the District certain oversight responsibilities. In August of 2000, the District, MPHS, and Sutter approved a Letter of Intent incorporating preliminary terms of a global settlement, including dismissal of the District's lawsuit. The District and MPHS are currently negotiating what would be final contractual terms of the "restructured relationship." If

the District, MPHS, and Sutter reach final contractual terms, the terms of the “restructured relationship” will be placed on an upcoming ballot for approval or disapproval by voters residing in the District.

The District’s Board of Directors, including Director Hanko, will be called upon to give direction to the District’s negotiators, including voting on certain agreements to be incorporated in the final deal, and to ultimately vote to approve or disapprove the final agreements with MPHS, which will likely include Sutter as a signatory to the main or ancillary agreements. Final approval will also encompass the dismissal of the pending litigation.

**Director Hanko and Baxter:**

Director Hanko was elected to the District board for the first time in November of 2000. Director Hanko is employed by Baxter Healthcare Corporation, a Fortune 500 company conducting business worldwide in pharmaceutical and healthcare supplies. She also owns stock that has a value in excess of \$2,000. Director Hanko is a “Pharmaceutical Products Specialist” for Baxter. Her duties consist mainly of marketing certain Baxter pharmaceutical products to healthcare providers, including hospitals, long term care providers, surgery centers, and other health services providers. Her efforts on behalf of Baxter are focused on educating healthcare professionals in these various settings about Baxter products available to them, including product introductions and follow-up utilization and general information about the use of the products. Therefore, her representation of Baxter encompasses pre and post sales presentations. Director Hanko does not “take orders” or conduct actual sales transactions. Healthcare providers purchase Baxter products through independent specialty wholesale companies with whom the providers conduct orders and purchase transactions. The wholesale companies purchase and resell the Baxter products to these providers. MPHS purchases Baxter products in this manner. During calendar year 2000, MPHS purchases of Baxter products through the wholesale companies amounted to approximately \$387,400.

In addition to the salary from and investment in Baxter, her employer also provides a bonus payment based on overall sales of Baxter products within Ms. Hanko’s territory. The company annually establishes budgets for projected sales of product groups within a territory. It then creates a formula based on a target that is a percentage of projected total sales for a representative’s product group and territory. The target (e.g., 85% of projected gross sales for the calendar year) becomes a minimum threshold of overall product sales in the territory before any incentive income will be paid. If, during the year, the overall sales of the product group exceed the targeted percentage of projected sales, the representative may receive incentive compensation that increases with the amount of overall sales exceeding the minimum threshold target of gross sales. The budget and target sales formulas do not take into consideration any individual efforts by Director Hanko as a Baxter representative. The company cannot trace individual product sales to its representatives. Therefore, the budget and target sales formulas are based entirely on product gross sales performance.

The company reserves the right to, and occasionally does, change its projected sales budgets and threshold targets during the course of a year based on its evaluation of the company's health and changing market conditions. Likewise, the company reserves the right to cancel the incentive compensation program altogether, and employee representatives must acknowledge in writing that the incentive program creates no express or implied contractual right to extra compensation.

Baxter employs consultants who conduct regular surveys of Baxter product sales through the independent wholesalers that conduct actual orders and sales with providers, such as hospitals. Baxter can determine from these consultants the approximate gross sales of its products to individual purchasers. These estimates are approximate because of the method of data collection employed by the sales survey consultants. It is nevertheless possible to determine the approximate percentage of overall product sales in a given territory that are attributable to sales to a specific customer. In this manner, Director Hanko can estimate the percentage of overall Baxter sales in her coverage territory attributable to MPHS purchases at Peninsula and Mills hospitals. Based on the year 2000 incentive compensation she received, Director Hanko estimates that approximately \$1,000 of her total incentive compensation from Baxter could be attributed to MPHS purchases of Baxter products in 2000. It is likely (she has not made this calculation) that a somewhat larger amount of her year 2000 incentive compensation could be attributed to purchases of Baxter products by other Sutter-affiliated facilities in her coverage territory.<sup>2</sup>

## **V. Analysis**

Three letters have been received from the requestors related to this matter.<sup>3</sup> They are attached as Appendix A. The letter requesting the opinion dated March 28, 2002, made no substantive or factual arguments and instead referred to the November 20, 2001, letter that requested reconsideration. We therefore look to the November 20, 2001, letter as an outline of the issues that the requestor has requested we address. Commission staff's two letters responding to the original advice request and the request for reconsideration are attached as Appendix B.

### **A. Background – Law**

The Political Reform Act ("Act") requires that the assets and income of public officials which may be materially affected by their official actions be fully disclosed, and in appropriate circumstances, the officials should be disqualified from acting in order that conflicts of interest

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<sup>2</sup> We have requested information pertaining to Director Hanko's total year 2000 incentive compensation, so that we can determine the proportion represented by the portion attributed to MPHS. However, Director Hanko declined to provide this information. This information would be relevant in the context of an indirectly involved economic interest in doing the eight-step conflict of interest analysis.

<sup>3</sup> Two additional letters requesting advice on peripheral matters were also received and responded to by Commission staff. The advice given in those letters is not being challenged and, therefore, those letters are not addressed here.

may be avoided. (Govt. Code Section 81002(c)<sup>4</sup>.) “Public officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them.” (Section 81001(b).)

In accomplishing these goals, the Commission has developed an eight-step process. The first six steps essentially determine whether the conflict of interest exists. In this case, the entire focus of this opinion request concerns step three in the analysis. However, we set forth all six steps<sup>5</sup> as they are applied to these facts for your information. In each case the requirements or findings discussed under each step are undisputed by the requestor. They are:

*(1) Determine whether the individual is a public official, within the meaning of the Act. If the individual is not a public official, he or she does not have a conflict of interest within the meaning of the Political Reform Act.*

Director Hanko is a “member, officer, employee or consultant of a state or local government agency” and, therefore, is a “public official” subject to the conflict of interest provisions of the Act. (Section 82048; Regulation 18701(a).)

*(2) Determine whether the public official will be making, participating in making, or using or attempting to use his/her official position to influence a government decision.*

The director wishes to participate in decisions affecting MPHS.

*(3) Identify the public official’s economic interests.*

The director has an economic interest in Baxter based on the salary she receives, her employment position, and her investment of \$2,000 or more in Baxter. In their original letters analyzing the issue, Commission staff also opined that Director Hanko has an economic interest in MPHS because she can trace a portion of her incentive compensation, or bonus, equal to or in excess of \$500 to MPHS. She also has an economic interest in her personal finances.

There are six kinds of economic interests recognized under the Act:

- A public official has an economic interest in a business entity in which he or she has a direct or indirect investment of \$2,000 or more (Section 87103(a); Regulation 18703.1(a));
- A public official has an economic interest in real property in which he or she has a direct or indirect interest of \$2,000 or more (Section 87103(b); Regulation 18703.2);

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<sup>4</sup> All further statutory references are to the Government Code unless otherwise specified.

<sup>5</sup> We omit discussion of steps 7 (legally required participation) and step 8 (public generally) since these exceptions to the conflict of interest rules were not at issue.

- A public official has an economic interest in any source of income, including promised income, which aggregates to \$500 or more within 12 months prior to the decision (Section 87103(c); Regulation 18703.3);
- A public official has an economic interest in a business entity in which he or she is a director, officer, partner, trustee, employee, or holds any position of management (Section 87103(d); Regulation 18703.1(b));
- A public official has an economic interest in any source of gifts to him or her if the gifts aggregate to \$320 or more within 12 months prior to the decision (Section 87103(e); Regulation 18703.4);
- A public official has an economic interest in his or her personal finances (expenses, income, assets, or liabilities), as well as those of his or her immediate family. (Section 87103; Regulation 18703.5.)

*(4) For each of the public official's economic interests, determine whether that interest is directly or indirectly involved in the governmental decision which the public official will be making, participating in making, or using or attempting to use his/her official position to influence.*

While it is disputed in step 3 whether MPHS is an economic interest, it is undisputed that MPHS is directly involved in decisions before Director Hanko. A person, including a business entity or source of income, is directly involved in a decision before an official's agency when that person, either directly or by an agent: "(1) Initiates the proceeding in which the decision will be made by filing an application, claim, appeal, or similar request or; (2) Is a named party in, or is the subject of, the proceeding concerning the decision before the official or the official's agency. A person is the subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person." (Regulation 18704.1(a).)

MPHS is a named party in and the subject of a contract with the District, as well as in the litigation between the District and MPHS. The current negotiations between the District and MPHS were aimed toward a global settlement of the litigation by which MPHS (assisted with financing from Sutter) would construct and operate a new hospital on land leased from the District. Thus, to the extent MPHS would constitute an economic interest of Director Hanko, MPHS would be directly involved in the decision.

*(5) Determine the applicable materiality standard for each economic interest, based upon the degree of involvement determined pursuant to California Code of Regulations, title 2, section 18704.*

"Any reasonably foreseeable financial effect on a person who is a source of income to a public official, and who is directly involved in a decision before the official's agency, is deemed material." (Reg. 18705.3(a).) If MPHS is a source of income to Director Hanko and is directly involved in the decision before her agency, any financial effect, even a penny's worth, on MPHS

from the District's decision regarding the restructured relationship, including a global settlement of the litigation and the seismic compliance issues, is deemed material.

*(6) Determine whether it is reasonably foreseeable that the governmental decision will have a material financial effect on each economic interest identified pursuant to California Code of Regulations 18703.*

Regulation 18706 provides that “[a] material financial effect on an economic interest is reasonably foreseeable, within the meaning of Government Code section 87103, if it is substantially likely that one or more of the materiality standards (see Cal. Code Regs., tit. 2 §§ 18704, 18705) applicable to that economic interest will be met as a result of the governmental decision.” A financial effect need not be a certainty to be considered reasonably foreseeable. (*In re Thorner* (1975) 1 FPPC Ops. 198.) It is reasonably foreseeable that a decision on the contract and on the litigation between the District and MPHS, if MPHS were an economic interest of Director Hanko's, would have a material financial effect on MPHS under the applicable materiality standard.

## **B. Law Applicable to Commissions and Bonus Payments**

As stated above, the only part of the eight-step conflict of interest analysis that is at issue in this opinion request is step three. Step three of the eight-step analysis is: Identifying the public official's economic interests. The only disputed economic interest at issue in this opinion request is MPHS, specifically whether MPHS is a source of income to Director Hanko by virtue of the fact that a portion of bonus payments made to Director Hanko by her employer can be traced to purchases made by MPHS.

### **1. Statutes and Regulations**

An analysis of issue must begin with an examination of the statute at issue, section 87103(c). Prior to analyzing the statute, a brief review of the governing principles of statutory construction may be helpful.

“In statutory construction cases, our fundamental task is to ascertain the intent of the lawmakers so as to effectuate the purpose of the statute.” *Estate of Griswold*, 25 Cal. 4<sup>th</sup> 904, 910 (2001). The proper approach to construction of a statute is succinctly outlined as follows:

“We begin by examining the statutory language, giving the words their usual and ordinary meaning. [Citations omitted.] If the terms of the statute are unambiguous, we presume the lawmakers meant what they said, and the plain meaning of the language governs. [Citations omitted.] If there is ambiguity, however, we may then look to extrinsic sources, including the ostensible objects to be achieved and the legislative history. [Citation omitted.] In such

cases, we select the construction that comports most closely with the apparent intent of the Legislature, with a view of promoting rather than defeating the general purpose of the statute, and avoid an interpretation that would lead to absurd consequences.”

[Citations and internal quotation marks omitted.]

*Estate of Griswold, supra., Id.*

Therefore, in looking at the “source of income” issue, the statutory language is examined first, giving the words their usual and ordinary sense, to determine whether the statutes have a clear, unambiguous meaning. If the Commission decides that the statute has an unambiguous meaning, then “plain meaning” is applied and the interpretational task requires nothing further.

Section 87103(c) states:

“A public official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any of the following:

¶ . . . ¶

“(c) Any source of income, except gifts or loans by a commercial lending institution made in the regular course of business on terms available to the public without regard to official status, aggregating five hundred dollars (\$500) or more in value provided or promised to, received by, the public official within 12 months prior to the time when the decision is made.”<sup>6</sup>

Nowhere in this definition is there a limitation that the source of income must be the direct payor of the funds to the official. Nor is there a prohibition against attributing responsibility, where appropriate and possible to do so, to more than one source. When such limitations have been deemed appropriate, the Act has been amended to reflect the limitation. For example, in 1984, the Legislature added section 87103.5, which expressly excludes retail customers of a business engaged in retail sales to the public generally as sources of income to a public official who owns a 10% or greater interest in the business:

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<sup>6</sup> Under the Act, if a public official or member of his or her immediate family owns a 10% or greater interest in a business, the clients of the business are potentially disqualifying economic interests also. (Section 87103.) A public official is also required to disclose both the business and the sources of income to the business on his or her Statement of Economic Interests. This is because both the business and the customers of the business are sources of income to the public official. (Sections 82030 and 82107(b)(2).)



“Notwithstanding subdivision (c) of Section 87103, a retail customer of a business entity engaged in retail sales of goods or services to the public generally is not a source of income to an official who owns a 10-percent or greater interest in the entity if the retail customers of the business entity constitute a significant segment of the public generally, and the amount of income received by the business entity from the customer is not distinguishable from the amount of income received from its other retail customers.” (Govt. Code § 87103.5)

In 1991, the Legislature added section 87103.6, which expressly excludes as sources of income any person who pays application or processing fees to a public agency. Section 87103.6 states:

“Notwithstanding subdivision (c) of Section 87103, any person who makes a payment to a state agency or local government agency to defray the estimated reasonable costs to process any application, approval, or any other action, including but not limited to, holding public hearings and evaluating or preparing any report or document, shall not by reason of the payments be a source of income to a person who is retained or employed by the agency.”

This statute expressly excludes certain third-party transactions from the definition of “source of income” under section 87103(c). The clear implication from this latter enactment is that third parties can, indeed, be sources of income.

“Under well-established rules of statutory construction, where an exception to a general rule is specified by statute, other exceptions cannot be implied or presumed [*expressio unius est exclusio alterius*]. [Citation omitted.] In other words, a statute that enumerates things upon which it operates is to be construed as excluding from its effect all those things not expressly mentioned.” *Embarcadero Municipal Improvement District v. County of Santa Barbara*, 88 Cal. App. 4<sup>th</sup> 781, 793 (2001).

Under the rule of statutory construction set forth above, a third party, under the appropriate circumstances, can be a source of income within the meaning of section 87103(c).

Further, a business entity which is a parent or subsidiary of, or is otherwise related to, a business entity in which the official has a financial interest may be considered a disqualifying source of income. Under regulation 18703.1(c), when two entities have a close working relationship as a result of the public official’s investments, income or business position,

(Sections 87103(a), (c) or (d)), the actual source as well as the related business entities are deemed economic interests to the official.

The Commission has dealt with third party payments in the context of commission income as well. “Commission income” is defined in regulation 18703.3(c)(2) as “gross payments received as a result of services rendered as a broker, agent, or other salesperson for a specific sale or similar transaction.” Under this regulation, not only is an employer or business a source of income to an official, but any client who is a party to a transaction is also a source of income. Because commission income and bonus payments both trigger income from clients of a public official’s business or employer, in prior advice letters dealing with bonus payments, we have analogized such payments to commission income. Staff found it necessary to apply the regulation by analogy because in this case, there was no “specific sale or similar transaction,” which is a necessary part of the definition of “commission income.” Director Hanko’s incentive compensation payment does not qualify as commission income, because the incentive compensation payment is based on the volume of sales. Requestors concur with this conclusion in their request for reconsideration at page 1. However, there is nothing in the rulemaking file for regulation 18703.3 to indicate that this regulation was intended to encompass the entirety of possible situations in which there could be more than one source responsible for the same income paid to a public official.<sup>7</sup>

## **2. Advice Letters**

The issue of bonuses based on volume sales, such as Director Hanko’s “incentive compensation,” has been addressed in the *Larsen Advice Letter*, No. I-89-555, and the *Anaforian Advice Letter*, No. I-90-312. These letters are attached as Appendix C.

In *Larsen*, a Sutter County supervisor’s spouse was employed by an agricultural products processing company as the manager of a processing plant. The supervisor’s spouse was compensated by a fixed salary, coupled with bonuses based on the volume of processing. The company’s clients were primarily local farmers. In that letter, we concluded that the farmers, themselves, were the source of the income to the supervisor. This conclusion was based on the fact that the bonuses were akin to commission payments.<sup>8</sup>

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<sup>7</sup> Another area in which multiple parties have been identified as the source of income for the same income to a public official is in the setting of referrals. In the *Schenk Advice Letter*, No. I-90-460, we advised that where both the referring party and the client were jointly responsible for payment of fees, they were both sources of income to the public official. Although this is a somewhat different analysis from the bonus analysis presented in this opinion request, it presents another example of an area in which multiple parties have been determined to be a source of the same income to a public official under the Act.

<sup>8</sup> For example, Regulation 18703.3 provides that the sources of commission income in a specific sale or similar transaction for a real estate agent include: “(1) [t]he broker and brokerage business entity under whose auspices the agent works; (2) [t]he person the agent represents in the transaction; and (3) [a]ny person who receives a finder’s or other referral fee for referring a party to the transaction to the broker, or who makes a referral pursuant to a contract with the broker.” Further, Regulation 18703.3(c)(4) provides that “[f]or purposes of determining whether disqualification is required under the provisions of Sections 87100 and 87103(c), the full gross value of any

In *Anaforian*, a Fresno city council member was employed by a pharmaceutical company as a territory sales representative and district trainer, with the goal of increasing demand for the product line distributed by the company. In that capacity, the council member made sales calls and provided support services to anesthesiologists and anesthesiologists who might use the company's products. His compensation consisted of an annual fixed salary, a nominal quarterly stipend for his training services, and a quarterly bonus contingent on the overall volume of his sales of the company's products. Based on the reasoning employed in the *Larsen* letter, we concluded that the bonus was analogous to a commission and, therefore, the company's clients serviced by the council member were a source of income.

The factors considered in both decisions were: (1) the amount of the bonus in each case was based upon volume, and (2) the bonus payments were automatic, once the produce was processed, in the *Larsen* letter, and once sales reached a designated threshold, in the *Anaforian* letter. In addition, in the *Larsen* letter, the supervisor's spouse was able to identify the amount of the bonus payment attributable to each farmer. In the *Anaforian* letter, such specific identification was not possible. However, we concluded that, because the bonus was based on the total volume of sales, each of his clients was equally responsible for the bonuses.

In the instant matter, the amount of Director Hanks's "incentive compensation" is based on the total volume of sales within her coverage territory. Director Hanks is also able to estimate the portion of her "incentive compensation" that is attributable to sales to MPHS. The only feature that distinguishes Director Hanks's "incentive compensation" from the bonuses in *Larsen* and *Anaforian* is that Baxter reserves the right to cancel the "incentive compensation" program, and employee representatives must acknowledge in writing that the program does not create a "right" to extra compensation. Therefore, the bonuses are not automatic in the same sense as the bonuses at issue in *Larsen* and *Anaforian*. On the other hand, we have no information that the bonuses are discretionary, in that they may not be paid, absent a cancellation of the policy. In any case, because the bonus at issue was based on sales in the year 2000, the bonus has already been paid, and thus was income to her, which must have had a source. Income, received or promised, is a basis for disqualification for 12 months after receipt or promise. (Section 87103(c).) Therefore, pursuant our advice, Director Hanks's conflict would have continued through the year 2001. (*Coffey* Advice Letter, No. A-01-064.)

We have requested information concerning Director Hanks's incentive compensation for the year 2001, and whether an amount from that compensation in equal to or excess of \$500 can be traced to MPHS purchases of Baxter products in 2001, in order that we may determine whether there is an existing economic interest at issue in this opinion request. However, we have not been provided with that information. Therefore, we have no way of knowing whether this

opinion request presents a real present conflict situation.<sup>9</sup> In any event, the only information we have concerns the incentive bonus for the year 2000, which has been paid and is income to Director Hanko. Determining the source of that income is the ultimate issue involved in this opinion request.

Another issue addressed in advice letters in addition to “bonus payments” is the issue of whether there can be more than one source of income. Section 87103 does not define who is considered the “source” of income, but, as noted above, it is also not limited to a single source. Thus, the “source” of income has been determined through Commission advice based on the facts of specific situations or by Commission regulations. In most cases, the actual payor is the source of income. However, while the person who actually writes the payment instrument is generally the source, it is not always the case. In some cases, both by regulation and in Commission advice, the Commission has looked beyond the person signing a check to find, based on the specific facts, that some other person may also be considered the source of that income.

For example, in the *Hentschke* Advice Letter, No. A-80-069, a Carlsbad planning commissioner who was employed by a closely-held corporation was confronted with a decision that would not affect the corporation, but would substantially affect the president/majority shareholder of the corporation. We advised:

“In keeping with the purposes of the Act, we conclude that in this case the president/majority shareholder of the corporation for which Mr. Larson works may also be considered a source of income to Mr. Larson. Although for other purposes the corporation would be considered Mr. Larson’s source of income, there can be no question that in a closely-held corporation situation such as here the president/majority shareholder of a corporation effectively controls the employment relationship itself. Accordingly, we conclude that the majority shareholder is a source of income to Mr. Larson and that he should therefore disqualify himself from any decision which would have a material financial effect on the shareholder.”

Similarly in the present situation, MPHS controlled the portion of Director Hanko’s incentive compensation attributed to it by purchasing Baxter products, which Director Hanko marketed directly to MPHS. If MPHS chose to purchase pharmaceutical products manufactured

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<sup>9</sup> As noted above, income, received or promised, is a basis for disqualification for 12 months after receipt or promise. The analysis doesn’t change on an on-going basis because there is historical precedent establishing the likelihood of the continuation of the “incentive compensation” program. The program is currently in effect and, as long as the program is in effect, Director Hanko will be entitled to receive “incentive compensation” on the total sales volume in her territory, which includes MPHS. However, the analysis will have to be repeated every year to determine whether at some time the portion of her incentive compensation attributable to MPHS does not reach the \$500 dollar threshold.

by someone other than Baxter, Director Hanko would receive an incentive bonus that would be smaller in an amount proportionate to the amount attributable to MPHS's diverted purchases.

This is in contrast to the *Miller* Advice Letter, No A-99-019, cited by the requestors in their November 20, 2001, request for reconsideration. The *Miller* Advice Letter involves "thousands of individuals who bet on the horse races" and whether they are sources of income to an official who owns a racehorse. In that letter, staff rejected an assertion that the thousands of individuals who bet on horse racing were sources of income to the official/horse owner. This conclusion was based in part on the fact that the size of the purses for the races, i.e. what was paid to winning horse owners, was determined by rate schedules negotiated in advance of a race meeting by the Thoroughbred Owners of California and the Los Angeles Turf Club. The individual bettors had absolutely no control over the amount of the purse, either by how many bettors there were or by the amount they wagered.

In addition, the bettors had no intent to benefit the official by their wagers and the official had no face-to-face interaction with the thousands of individuals who bet on the race. Further, it was extremely unlikely that the official could identify the bettors, or determine to what extent they contributed to the official's share of the purse. This differs dramatically from Director Hanko's situation. In our original advice letter, the *Coffey* Advice Letter, No. A-01-064, the following facts were considered:

- The director's duties consist mainly of "marketing certain Baxter pharmaceutical products to healthcare providers, including hospitals, long term care providers, surgery centers, and other health services providers." This included MPHS, for example.
- "Baxter intends Director Hanko's representation to increase awareness and use of Baxter's products by healthcare providers within her coverage territory. Baxter therefore provides potential bonus payments to its representatives, including Director Hanko, based on overall sales of Baxter products within the *representative's* territory."
- "....Director Hanko can estimate the percentage of overall Baxter sales in her coverage territory attributable to MPHS purchases at Peninsula and Mills hospitals. Based on the year 2000 incentive compensation she received, Director Hanko estimates that approximately \$1,000 of her total incentive compensation from Baxter could be attributed to MPHS purchases of Baxter products in 2000. It is likely (she has not made this calculation) that a somewhat larger amount of her year 2000 incentive compensation could be attributed to purchases of Baxter products by other Sutter-affiliated facilities in her coverage territory."
- "The District's Board of Directors, including Director Hanko, will be called upon to give direction to the District's negotiators, including voting on certain agreements to be incorporated in the final deal, and to ultimately vote to approve or disapprove the final agreements with MPHS, which will likely include Sutter as a signatory to the main or

ancillary agreements. Final approval will also encompass the dismissal of the pending litigation.”

Requestors cite in their November 20, 2001, letter the *Kuperberg* Advice Letter, No. A-99-223, for the proposition that control of the funds by the payor is the key factor at issue in determining source of income. The facts of that letter are also dissimilar to those here and only minimally address the source of income issue. In that letter we stated: “. . . Mayor Shea’s former spouse paid child support to her for four years until the youngest child was 18 years old. He currently pays her alimony. Presumably, the mayor’s former spouse did not make a child support payment in the last 12 months. (§ 87103(c).) Moreover, the term ‘income’ excludes alimony and child support payments. (§ 82030(b)(7).) Therefore, Mayor Shea does not have an economic interest in her former spouse as a source of income.” Consistent with the conclusion that the official’s spouse who paid the alimony was not a source of income in the first instance, we went on to conclude that the spouse’s employer was also not a derivative source of income.

In our written advice to Director Hanko, we focused on and considered the following: (1) she marketed Baxter products directly to MPHS; (2) her representation of Baxter was intended by the company to increase awareness and use of its products by healthcare providers within her coverage territory, and therefore, her incentive bonus was based on overall sales of Baxter products within her territory; (3) Director Hanko is able to estimate the approximate amount of her incentive compensation for the year 2000 attributable to MPHS purchases that year; and (4) the board, including Director Hanko, would be called on to direct the District’s negotiators and to vote on various agreements, including the final agreement, which will encompass dismissal of the pending litigation. Based primarily on the fact that Director Hanko could identify the amount of her incentive bonus that was directly attributable to MPHS purchases of Baxter products, and following the prior advice that had been given in the *Larsen* and *Anaforian* letters, we concluded that MPHS is a source of income to Director Hanko, and that she, therefore, has a disqualifying conflict of interest in voting on the decision regarding the contract between the District, MPHS and Sutter. We believe that this conclusion is correct because Director Hanko is able to attribute funds totaling at least \$500 (the threshold for an economic interest in a source of income) from her incentive compensation directly to MPHS. Where responsibility for monetary remuneration in excess of the threshold can be clearly identified by a public official in this manner, we believe that it creates the same potential for a conflict that an employer/employee relationship entails, i.e. a party with some measure of financial control over the public official.

According to their opinion request dated March 28, 2002, the requestors contend the analysis in our original advice letter and the reconsideration letter were incorrect because “control and the right to receive payment were the essential analytical support for the prior advice, [and] the absence of those elements here should have led to a different result.” (Brown letter, March 28, 2002, page, 3 (App. A).) First, we disagree that the two elements identified by the requestors were “the essential analytical support” for either the *Larsen* or the *Anaforian* Advice Letters. Equal, if not greater, emphasis was placed on the ability to identify the clients to whose business the bonus could be attributed. Further, the definition of “control” applied in both

letters could apply equally to MPHS in the present situation. Neither letter's fact pattern contained any information relating to control over the amount of the bonus, but only to the actual receipt of the bonus. Under both fact patterns, as in this opinion request, the bonuses were based on volume, either in sales or in processing. In the *Larsen* Advice Letter, we stated:

“[A]bsent contrary information, these farmers appear to have control over whether or not the spouse receives the bonus income attributable to their produce. The farmers could choose to do just enough business with the processor to eliminate the bonus, or in the alternative, could increase their business with the processor to significantly enhance the bonuses received by the spouse.”  
(*Larsen, supra*, I-89-555.)

Likewise, in the *Anaforian* letter, because the bonus payments were automatic if sales reached the designated thresholds, we said that the buyers appeared to be able to control the bonus income of the advisee. In the instant matter, MPHS could control Director Hanko's incentive compensation to an equal degree, simply by choosing to purchase pharmaceuticals manufactured by someone other than Baxter.

The requestors will argue that the difference is the other factor they site as being “essential,” i.e. Baxter reserves the right to cancel the incentive compensation program, whereas in both the *Larsen* and *Anaforian* letters, the bonuses were automatic. However, as noted above, in this opinion request, we are dealing with a bonus that Director Hanko has already been paid for the year 2000. It is not contingent, but is already income that she has received.<sup>10</sup>

### **C. Recommendations Regarding Options**

We recommend that the Commission ratify the advice in the staff letter declining reconsideration of this issue, (*Brown* Advice Letter, No. A-01-286), and thus decline to move forward on this opinion, or issue an opinion concluding that bonus payments paid by an official's employer and triggered by sales to a specific customer causes that customer to become a source of income to the official for purposes of section 87103(c).

In the alternative, staff recommends that the Commission modify the staff advice, placing some limitations on the rule as to when bonus income may be imputed to a client as its source, such as: (1) requiring that the public official have personal contact and dealings with the client; (2) requiring that the client be identifiable that the bonus income be traceable to the client; and (3) requiring that the bonus have been received or that the official be legally entitled to receive

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<sup>10</sup> In addition to her economic interest in MPHS, Director Hanko also has an economic interest in her personal finances, which are defined to include her expenses, income, liabilities, or assets, as well as those of her immediate family. (Section 87103 and Reg. 18703.5.) We have not been asked to analyze, nor have we performed an analysis, of these facts as they relate to the personal financial effects rule.

the bonus. We further recommend that the Commission direct staff to place this on next year's regulation calendar for further definition and clarification.

In any event, staff recommends against abandoning the rule entirely.